

Study on Laws Governing Banking and Insurance Sector

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Abstract: *Legislative and judicial efforts to protect the interest of banking institutions were initiated after an estimation of an increase in banking fraud and non-performing assets in the banking sector over the past decades. In continuation of the same, the apex court issued two major judgements in 2017, one of which dealt with the consideration of bail applications in money laundering cases and the other with the validity of the Insolvency and Bankruptcy Code of 2016. It attempted to strike a compromise between protecting the interests of investors and banking institutions and punishing the perpetrators and fraudsters. Nevertheless, a review of the decisions of courts, particularly the high court and supreme court, is necessary in light of the rapid economic developments occurring in both the international and domestic arenas in the present day. This chapter examines a selection of decisions to provide insight into this rapidly developing area of economic law.*

Keywords: Banking

I. INTRODUCTION

One of the pivotal challenges faced by banking sector in India is the slow pace of recovery of defaulting loans advanced to the customers by banks which results in mounting levels of non-performing assets. The delayed pace of recovery of defaulting loans issued to clients by banks, resulting in rising levels of non-performing assets, is one of the most significant obstacles facing the banking sector in India. Despite the multiple legislative steps adopted by Pvt. Ltd. v. Hero Fincorp Ltd.,¹ the subject of the effect of some SARFAESI provisions superseding those of the Arbitration and Conciliation Act, 1996 was decided in a most unsatisfactory manner. Previously, the Court discussed and rendered a decision on a comparable problem involving a different piece of legislation. Government-based on the recommendations of the Andhyarjunia Committee as well as the Narasimham Committees I & II, the burden on the judiciary to decide matters governed by this statute increases each year. The courts in India dealt with a variety of difficulties arising from the provisions of this legislation in 2017 as well, albeit with many of them reiterating previously established concepts. Thus, the highest court in the state of M.D.Frozen food exports pvt. ltd.

II. SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 (SARFAESI)

Typically, borrowers obtain loan approvals from banks in a rush, and when it comes time to repay the loan, they encounter difficulties. They employ a variety of strategies to delay the repayment of bank loans. In this case, the court applied the doctrine of election and ruled against the decisions of the High Courts of Andhra Pradesh and Orissa. Regarding the question of the application of any other legal proceedings concurrently with the SARFAESI proceedings, the court upholds the decisions of the full bench in Sarthak Builders Pvt Ltd v. Orissa Rural Development Corporation Ltd, HDFC Bank Ltd v. Satpal Singh Bakshi,⁶ and the Division Bench of the High Court of Allahabad in Pradeep Kumar Gupta v. State of Uttar Pradesh. ⁷ In the present case, the Supreme Court must determine whether SARFAESI proceedings and arbitration proceedings will run concurrently. The court ruled that since SARFAESI proceedings are in the nature of enforcement proceedings and arbitral proceedings are adjudicatory in nature, a secured creditor can proceed against other assets after determining the outstanding amount if secured assets are insufficient to satisfy debts, and the provisions of arbitration are not in conflict with SARFAESI provisions. The supreme court correctly emphasised that any impetus to the industrial development of the country is contingent on the encouragement provided to banks and financial institutions to formulate a liberal policy for the granting of loans coupled with a quick and

effective recovery process. Currently, a lack of proper implementation of an effective mechanism under the SARFAESI Act for the recovery of customer-defaulted loans is one of the factors contributing to the rising rate of nonperforming assets in the banking sector.

In this case, it was also questioned whether the lender could invoke the SARFAESI Act when its notification as a financial institution under section 2(1)(m) was issued after the account became an NPA under section 2(1) of the Act. The Court answered the question by analysing the purpose of the SARFAESI Act as well as the rationale applied by the Parliament when implementing the Act to financial institutions, and determined that the scheme of the SARFAESI Act is to provide a procedural remedy against a previously created security interest.

III. RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993

In *Narendra Plastic Private Limited v. DBS Bank Limited*,²⁰ the High Court of Bombay ruled that an ex parte order cannot be vacated solely because summons was not served on the director at the company's address in a recovery proceeding initiated under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. (RDDBFI). Regarding proceedings under the RDDBFI and SARFAESI, the Regulation of Practice, 2010 (RP) of the Debts Recovery Tribunals for the States of Maharashtra, Gujarat, Goa, and the Union Territories of Dadra and Nagar Haveli, Daman and Diu have been formulated. Therefore, regulation pertains to the service of a summons or notice. Regulation 19(4) of RP states that it is sufficient service if the summons or notice is served on the Secretary, Director, or other principal officer of the Corporation or the Partner of the Partnership Firm at its registered office or at the address of the Partnership Firm. Also, if the notice is sent to the registered address of the company, even if it is not claimed, this shall be considered acceptable service. Specifically, regulation 19(6) RP states that if the summons or notice is returned with postal remarks such as 'refused,' 'unclaimed,' 'not claimed,' 'intimated,' or 'intimation given,' the summons or notice may be declared served. In this instance, the petitioners are attempting to avoid repaying the bank that granted them a loan. In accordance with section 30A of the RDDBFI Act, they were unwilling to even make the required pre-deposit before the tribunal in order for it to hear an appeal. The high court also denied them any equitable relief of reduction of the pre-deposit amount and refused to exercise extraordinary jurisdiction under article 226 of the Indian Constitution.

IV. BANKING REGULATION ACT, 1949

In *Gorakhpur Steels & Metals Private Ltd v. Presiding Officer, Debts Recovery Tribunal*, the High Court of Allahabad analysed the definition of the term "banking" under the Banking Regulation Act of 1949. (BR). It was determined that in its simplest form, "banking" as defined by section 5(b) of the BR Act does not include the right to deal in securities acquired at the time of lending. Securities exist solely to guarantee recovery of outstanding debts. In the event that the borrower fails to honour his or her obligations, the bank may seize the collateral. The plain language of said provision precludes any other interpretation. The primary meaning of 'banking' is accepting deposits of money from the public that are repayable on demand or otherwise, and allowing withdrawal of such deposits via check, draught, etc. Accepting such deposits is done for lending or investment purposes. Section 5(ca) of the BR Act defines "banking policy" as any policy periodically specified by RBI in the interest of (a) the banking system, (b) monetary stability, and (c) sound economic growth. The policy must be formulated with depositors' interests, deposit volume, and other bank resources in mind.

V. PREVENTION OF MONEY LAUNDERING ACT, 2002

In money laundering crimes, money launderers continue to be one step ahead of law enforcement. At this juncture, it must be made clear that the expansion of anti-money-laundering regimes to new economic sectors is directly attributable to the innovations implemented by these individuals. The purpose of the PMLA is, on the one hand, to prevent this economic offence and, on the other, to punish offenders severely. As this is a special statute, the provisions of other statutes do not generally apply to cases filed under this statute. In *Union of India vs. Varinder Singh*⁴¹, the Supreme Court reaffirmed the principle that in cases involving money laundering, "jail is the rule and bail is the exception" for those who commit this economic crime. The apex court revoked the high court's bail order and noted that section 45 of the PMLA will supersede the general provisions of the Code of Criminal Procedure in the event of a conflict. In addition, the two conditions for the granting of bail specified in section 45 of the PMLA indicate that the

legislature has created an exception for the granting of bail by a Special Court when the defendant is under 16 years of age, a woman, or sick or infirm. Therefore, the section 45-A conditions are binding on the high court when deciding on a bail application related to a money laundering offence. In its decisions in Gautam Kundu Vs. Directorate of Enforcement (Prevention of Money Laundering Act)⁴³ and Rohit Tandon v. The Enforcement Directorate, the apex court strictly adhered to the provision relating to bail in money laundering cases, which is of vital importance. In the case of Rohit Tandon, the bench of Dipak Misra, CJ, A.M. Khanwilkar, and D.Y. Chandrachud, JJ stated, "the consistent view taken by this Court is that economic offences involving deep-rooted conspiracies and huge loss of public funds must be viewed seriously and considered as grave offences affecting the economy of the country as a whole and thereby posing a serious threat to the financial health of the country."

VI. INSOLVENCY AND BANKRUPTCY CODE, 2016

The Insolvency and Bankruptcy Code (IBC) was enacted by the government in an effort to find an appropriate resolution for stressed assets, and the National Company Law Tribunal (NCLT) was tasked with putting in place proper resolution mechanisms within a short period of time. In due course, it was determined that the earlier mechanism to address the issue of stressed assets and the recovery action by creditors through special laws such as the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, the SARFAESI Act, 2002, and the Sick Industrial Companies (Special Provisions) Act, 1985 were neither able to aid recovery for lenders nor restructuring of firms. It was observed that, rather than reviving sick industries, the process created a protective shield for the debtors, and nobody can recover money from them once they enter the revival process. This, in turn, caused non-performing investments to become even less profitable and prevented banks from pursuing defaulters for repayment.

When lenders lack confidence, borrowers have less access to credit. This is reflected in the condition of India's credit markets. The largest portion of India's credit market consists of bank-issued secured loans. It also intended for the Debt Recovery Tribunal and National Company Law Tribunal to serve as Adjudicating Authorities and handle cases pertaining to insolvency, liquidation, and bankruptcy processes for individuals and unlimited partnership firms, and for corporations and limited liability entities, respectively. The objective of establishing the Insolvency and Bankruptcy Board of India was to exercise regulatory control over insolvency professionals, insolvency professional agencies, and information utilities. During the infancy of this legislation, a number of issues pertaining to constitutionality, legal validity of lawyer's notice, withdrawal of application after admission by the NCLT, relaxation of time period, definition and scope of 'dispute' under IBC were examined in a number of cases filed before the highest court.

In *I Innoventive Industries Ltd v. ICICI Bank*,⁵² the supreme court determined the constitutionality of the IBC. This is possibly the first time the highest court has ruled on the operation and functioning of the IBC. In order for all courts and tribunals to observe the paradigm shift in the law brought about by insolvency and bankruptcy proceedings, the court rendered a comprehensive decision on a number of crucial issues pertaining to the implementation of the Code.

In this case, ICICI bank filed a petition with the Mumbai NCLT to initiate the corporate insolvency resolution process against Innoventive Industries Ltd. This is the first application filed under Section 7 of the Insolvency and Bankruptcy Code as a result of the company's failure to repay amounts owed under certain bank credit facilities. The company argued before the tribunal that the bank's application is suspended due to a relief order issued by the Government of Maharashtra under the Maharashtra Relief Undertaking (Special Provisions) Act 1958 (MRUA), which allows the state to declare industries it has taken over as "relief undertakings" by means of a government notification.

VII. INSURANCE

In *Om Prakash v. Reliance General Insurance*, the Supreme Court ruled that rejection of claims based solely on technical grounds in a mechanical manner would undermine policyholders' faith in the insurance industry; consequently, insurance claims cannot be rejected on technical grounds. If the reasons for the delay in filing a claim are adequately explained, the claim cannot be denied on the basis of delay. Furthermore, once such claims have been verified and found to be accurate by the investigating officers, it is neither fair nor reasonable to reject them on the basis of technical flaws. In this instance, the insurance policy stipulated "immediate notification to the insurer of the loss/theft of the vehicle." In this case, the insured appellant failed to comply when his truck insured by the insurance company was stolen. In another precedent-setting case, *National Insurance Co Ltd. v. Pranay Sethi*, the supreme court issued

guidelines for determining the future prospects of a motor vehicle accident claim. The five-judge bench unanimously agreed to consider the future prospects of deceased victims of motor vehicle accident cases when determining their income for the purpose of calculating their compensation claims. This is a landmark decision in the field of insurance. It stated, "It would be unjust to follow the doctrine of actual income at the time of death and not add any amount based on future prospects in order to determine the multiplicand." The court also stated that this concept must be applied uniformly to both salaried employees and self-employed individuals. The court's reasoning is truly commendable, particularly when it explained that the purchasing power of a salaried person with a permanent job increases as a result of increments, pay revisions, or other changes in service conditions, and that there is always a competitive attitude in the private sector to increase salaries in order to obtain greater employee productivity. Similarly, a self-employed individual is required to gather his resources and increase his rates/fees in order to maintain the same standard of living. Regarding self-employed individuals, it was stated that "to have the perception that he is likely to remain static and his income to remain stagnant is contrary to the fundamental concept of human attitude, which always intends to live with dynamism and adapt to the times." The apex court also relied on and summarised the decision of Sarla Verma v. Delhi Transport Corporation, for determining the multiplicand, the deduction for personal and living expenses, and the multiplier.

The court has outlined the following guidelines for the computation of compensation:

- When calculating the deceased's income, 50% of the deceased's actual salary should be added for future prospects if the deceased had a permanent job and was younger than 40 years old. If the deceased was between 40 and 50 years old, a 30% supplement should be applied. If the deceased was between 50 and 60 years old, a 15% premium should be added. Actual salary should read after-tax actual salary.
- If the deceased was self-employed or on a fixed salary, the warrant should be 40% of the deceased's established income if they were under 40 years old. Consider an addition of 25% if the deceased was between the ages of 40 and 50, and 10% if the deceased was between the ages of 50 and 60, as the required method of computation. The taxable income is the taxable income minus the tax component.
- The multiplier should be applied based on the decedent's age. Reasonable figures for conventional heads, namely loss of estate, loss of consortium, and funeral expenses, should be Rs. 15,000, Rs. 40,000, and Rs. 15,000, respectively. The aforementioned amounts should be increased by 10% every three years.

VIII. CONCLUSION

This year's leading case analysis reflects the judicial dynamism toward economic growth and individual liberty protection. It is a matter of concern that the lower judiciary lacks the expertise to handle cases under the SARFAESI Act, and that such cases must be referred to the high court for correction before being sent back to the same court for a decision based on statutory principles. The Magistrate's authority under the SARFAESI Act is limited to providing the necessary police force, if required, for the secured creditor; he or she has no adjudicative authority. In the interest of economic growth, this highlights the literal rule of interpretation and the need for minimal judicial intervention in matters relating to the recovery of loans from secured creditors, particularly banks and financial institutions. The supreme court correctly upholds the constitutionality of the IBC, which is advantageous legislation for secured creditors. Nonetheless, courts must be more vigilant when deciding cases under this provision, as irresponsible borrowing and risky ventures occur without regard for accountability, and banking officials are sometimes involved in aiding defaulters. Similarly, with regard to money laundering cases, the dilution of bail provision and striking of the twin principle of section 45A require additional review in light of the rise of fugitive offenders in this area and the peculiar nature of the underlying crime. Regarding insurance, the supreme court's guidelines regarding the compensation of victims of motor vehicle accidents demonstrate their humane attitude toward the insured. In the coming years, the judiciary will require more expert judges to decide the complexities in the field of banking and insolvency laws in order to ensure the effective implementation of laws that aim to expedite the resolution of disputes that have a negative impact on the development of the nation as a whole and the corporate sector in particular.

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